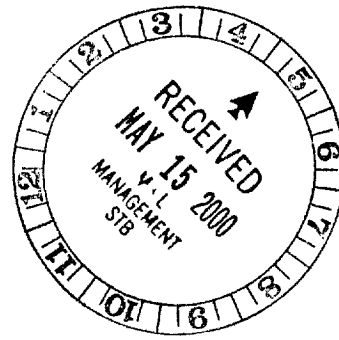


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BEFORE THE
SURFACE TRANSPORTATION BOARD

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STB Ex Parte No. 582 (Sub-1)

MAJOR RAIL CONSOLIDATION PROCEDURES

JOINT COMMENTS OF
KANSAS DEPARTMENT OF TRANSPORTATION
KANSAS CORPORATION COMMISSION
KANSAS OFFICE OF THE ATTORNEY GENERAL

Come now the Kansas Department of Transportation ("KDOT"), the Kansas Corporation Commission ("KCC") and the Kansas Office of the Attorney General ("KOAG") (collectively, "the Kansas Agencies") and file their joint comments in this docket before the Surface Transportation Board ("Board").

I. INTRODUCTION

A. THE PARTIES

KDOT is authorized by the State of Kansas to coordinate the planning, development and operation of the various modes and systems of transportation in Kansas. KDOT has represented the public interests of the State of Kansas in a number of Board proceedings. KDOT is the designated state rail-planning agency pursuant to 49 U.S.C. 1654 and administers the Local Rail Freight Assistance Program. KDOT is responsible under the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA), 23 USC 1000 *et seq.* for the development and implementation of the state long range planning process, statewide transportation plan, and intermodal transportation management system. The Office of Rail Affairs, within KDOT, coordinates all rail transportation matters.

KCC was originally formed in the 1880s as the Board of Railway Commissioners. KCC is currently charged with regulation of public utilities, common carriers and motor carriers within the State of Kansas. KCC was the local agency that generally regulated the rail industry in the State of Kansas as a common carrier until the deregulation of the industry began with the Staggers Act of 1980 and the Interstate Commerce Commission Termination Act of 1995. With the extensive deregulation of the industry and the exclusive nature of the Board's jurisdiction, KCC's remaining jurisdiction over rail carriers is largely confined to the administration of rail crossing safety within the state.

KOAG appears on behalf of the state of Kansas in legal matters in which the state has an interest in the litigation.

As representatives of the people and interests of the State of Kansas, the Kansas Agencies' purpose in this matter is to reinforce the "public interest" aspect of this proceeding by focusing on the present and future effects of rail mergers on the Kansas public. Based on a review of the relevant issues, the Kansas Agencies are concerned with the effects the present merger regulations have on its affected citizens and businesses.

As the Board stated in its March 31, 2000 Advanced Notice of Proposed Rulemaking, the original merger rules currently utilized by the Board were originally instituted by the now extinct Interstate Commerce Commission ("ICC") shortly after the Staggers Act of 1980 which began the deregulation of the rail industry. At that time, the goal was to rationalize excess capacity so long as competition, access to essential service, and other public interest goals were not degraded. As the Board further acknowledged, however, it appears that the goals of that merger policy have been achieved and that the focus must shift to how to improve profitability of the railroads through enhancing the service provided to their customers. The Kansas Agencies agree with the Board's conclusions.

The Rail transportation policy of the United States Government as stated in the Staggers Act has not changed, and warrants repeating:

In regulating the railroad industry, it is the policy of the United States Government--

(1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;

(2) to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required;

(3) to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the Board;

(4) to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense;

(5) to foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes;

(6) to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital;

(7) to reduce regulatory barriers to entry into and exit from the industry;

(8) to operate transportation facilities and equipment without detriment to the public health and safety;

(9) to encourage honest and efficient management of railroads;

(10) to require rail carriers, to the maximum extent practicable, to rely on individual rate increases, and to limit the use of increases of general applicability;

(11) to encourage fair wages and safe and suitable working conditions in the railroad industry;

(12) to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination;

(13) to ensure the availability of accurate cost information in regulatory proceedings, while minimizing the burden on rail carriers of developing and maintaining the capability of providing such information;

(14) to encourage and promote energy conservation; and

(15) to provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part.

B. RELEVANT LAW

Under 49 U.S.C. §11344(c), the Board is required to approve and authorize a rail consolidation or control transaction consistent with the public interest. In applying this public interest test, the Board has long been guided by the Congressional intent to "encourage mergers, consolidations, and joint use of facilities that tend to rationalize and improve the Nation's rail system."

Consistently the Board has balanced the public benefits of the transaction against the costs of the transaction, where the public benefits encompass more efficient service and increased competition balanced against the costs of any adverse effects on competition or loss of essential services. Thus, the Board performs a balancing test, weighing the "potential benefits to applicants and the public against the potential harm to the public." In applying its public interest balancing test, the Board has considered reduction in competition as a potential harm. The criteria for imposing conditions to remedy anti-competitive effects were set out in *Union Pacific--Control--Missouri Pacific; Western Pacific*, 366 I.C.C. 462. The Board stated that it will not impose conditions unless it finds that the consolidation may produce effects harmful to the public interest (such as a significant reduction of competition in an affected market), that the conditions to be imposed will ameliorate or eliminate the harmful effects, that the conditions will be operationally feasible, and that the conditions will produce public benefits (through reduction or elimination of the possible harm) outweighing any reduction to the public benefits produced by a merger. Based on this case law the Board is well within its statutory and administrative mandate to review its merger regulations in the light of changed circumstances since their original enactment.

II. COMMENTS FOR CONSIDERATION IN RESTRUCTURING LARGE RAIL MERGER RULES

The Kansas Agencies, like the Board, are responsible to its citizens and shippers to weigh the benefits and harms of proposed changes to its transportation system. The Kansas Agencies have reviewed the Board's March 17, 2000 decision and agree with the Board's statement that:

[T]he rail community is not now in a position to undertake what would likely be the final round of restructuring of the North American railroad industry, and that our current rules are not adequate for addressing the broad concerns associated with reviewing any proposals that, if approved, would likely lead to just two large North American transcontinental railroads. We therefore announced that we would revise our merger rules, and, because we determined that it made no sense to develop new merger rules in the middle of what could likely be the final round of major rail mergers, we announced that we would decline to accept further filings involving a major transaction (defined at 49 CFR 1180.2(a)) until new merger rules are in place.

The Kansas Agencies are very concerned with predictable and reliable rail service to transport Kansas agricultural products, as well as coal shipments to Kansas utilities. The Kansas Agencies note that in 1980, when rail deregulation began, there were 33 class I rail carriers. Today, there are seven. In 1980, there were 254,251 miles of track across the United States. Today, that number has fallen to 169,798. Kansas itself has lost over 30% of its rail lines in the last thirty years. The mergers, and the subsequent massive line reductions, have had an adverse impact on grain and coal shipments out of and into the state of Kansas.

The Kansas Agencies believe that several areas require scrutiny while the Board considers revisions to its merger rules. In particular, the Kansas Agencies would suggest the Board consider the following: accepting local input and imposing local conditions on mergers to prevent harm to

local concerns in favor of long-distance transport; afford certain protections to captive or specially reliant rail customers; and the adoption of a short line railroad “Bill of Rights.” The Kansas Agencies’ specific comments in these regards are as follows:

A. GREATER PROVISIONS TO ADDRESS LOCAL CONCERNS

The Kansas Agencies believe that a portion of the problems associated with large rail mergers can be attributed to the lack of significant consideration of local concerns. Pursuant to 49 U.S.C. 11321, the Board has exclusive authority over rail mergers. At the same time, 49 C.F.R. 1180.4(c)(5)(i) currently requires service of a merger application on the “Governor (or Executive Officer), Public Service Commission, and the Department of Transportation of each State in which any part of the properties of the applicant carriers involved in the proposed transaction is situated.....” The Kansas Agencies believe that, while the final decision on any merger application ultimately remains with the Board, a Board policy articulated in its merger rules which gives significant weight to local opinion and suggestions would provide some necessary safeguards, and assist in assuring that the policy of the United States as stated in the Staggers Act is followed in all respects.

Historically, railroad operations were thought to be vested with a significant public interest as a common carrier requiring close oversight on a national *and* local level. Railroads were considered much like today’s public utilities. Obviously, the industry has changed significantly over time. The public in general no longer relies as heavily on the rail industry as it still does other public utility service. However, there are still segments of the public with a deeply vested interest

in the industry, and those segments are largely localized. Although these rail customers may have similar interests from region to region, they are not exactly the same.

In Kansas, those interests rest in the agricultural and electric industries. As explained further below, Kansas farmers are dependent on modes of transportation for shipments of grain. As also explained further below, Kansas is home to several coal-fired electric generation facilities which are solely dependent on rail transportation for their coal shipments. While there are agricultural and coal concerns nation-wide, the Kansas Agencies believe that concerns peculiar to Kansas grain and coal shippers could not necessarily be adequately addressed by a nation-wide policy in a merger decision.

The Kansas Agencies believe that a specific regulation guiding state participation in rail merger proceedings would be helpful. Perhaps such a regulation could specify that states or specific state agencies be made active parties to the merger proceedings, and be served with the pre-merger notice as well as merger application. States would then have more than adequate notice in order to properly prepare a reasoned and supported position to present in the proceeding. Further, a regulation specifying that a Board merger decision could be conditioned to meet specific local concerns would provide notice to the rail industry that local voices will be heard and given due weight by the Board in its decision.

1. The Agricultural Community

Transportation is a huge variable cost grain producers must absorb to move their product from field to first point of sale. Production agriculture is a price-taker and all cost increases, which include higher transportation costs, decrease the producers' net incomes.

Statistics demonstrate that reduced competition for agricultural operations as shippers of commodities has resulted in the movement of grain by truck rather than by rail. To illustrate, in 1988, 80% of wheat shipment was by rail; in 1998, that number dropped to 47%. In 1987, 58% of corn shipment was by rail; in 1998, that number dropped to 21%. In 1988, 43% of sorghum shipment was by rail; in 1998, that number dropped to 41%. In 1988, 61% of soybean shipment was by rail; in 1998, that number has fallen to 29%. It takes 3 ½ semi-trailers to haul the grain of a single rail car. While the number of trailers that can be transported by one truck tractor is limited, a rail carrier can easily haul 100 grain cars over its lines. Rail shipment of grain is frequently more efficient, economically and operationally, for Kansas producers. Yet it is a rapidly decreasing option. Class I rail carriers do not like to take on intrastate grain shipments. Class I carriers prefer long distance transport to increase their profitability. While increasing profit is a valid business concern, it does not benefit customers who are specially reliant on that business's service, particularly when that business is peculiarly vested with public interest concerns. Because of creative barriers to competition that have adversely affected short line railroads, the most viable alternative to Class I shipments, grain producers are left only with the trucking industry alternative. While the Kansas Agencies believe that the trucking industry provides valuable services in Kansas and elsewhere, Kansas producers and other consumers of commodity transportation services should have the choice of whether to ship by rail or by truck.

Also impacting the agricultural customer is the trend toward identity preservation. To meet the quality demands of the end-user of the agricultural commodity, the producer must segregate its product based on certain specified quality characteristics. Producers are also caught in the middle

of the biotechnology debate and the ensuing demands for segregation that have arisen as a result. With the increasing rail emphasis on speed of loading and quantity of shipment, the demands of identity preservation and segregation may fall to the wayside. The agricultural community of Kansas may be faced with lost markets because it does not have the transportation availability to deliver the product the customer requires.

2. The Coal-Fired Electric Generation Facilities

Although power to the state of Kansas is provided in part by the nuclear facilities at Wolf Creek, the state does still rely on coal-fired generation as a power source. Over 70 percent of the electric power generated in the state comes from coal-fired power plants. Those coal shipments are made by rail to the generation sites. These facilities are captive customers of the rail industry. The transportation costs of the coal needed to generate electricity, as well as the cost of buying electricity from outside sources to meet load obligations when a coal-fired generation unit is unable to properly function, may be considered a part of the cost of service for utilities that is ultimately paid by the electric consumer. The Kansas Agencies are concerned because prior mergers have resulted in numerous complaints and problems for utilities that require timely coal shipments. As a consequence the utilities have been left in the position of paying increased prices to get the coal or purchasing electricity from outside sources to meet load requirements. The Kansas Agencies believe that it is a real possibility that continued mergers may be continued problems for Kansas utilities in this regard.

Western Resources, Inc. ("WRI") is one notable example. In its Comments at the Public Hearing filed in STB Ex Parte No. 582 on February 29, 2000, WRI indicated that it ships

approximately 11 million tons of coal by rail from mines in the western United States to its coal-fired facilities in Kansas. It also cited in those Comments that it had been directly and negatively impacted by the previous BN - SF and UP - SP mergers economically and operationally, including massive service disruptions, non-communication due to railroad organizational restructuring, economic losses by shippers, and strained business relationships.

3. Protecting the Agricultural and Utility Interests

Due to the service failures of the most recent mergers, the Kansas Agencies have some trepidation on new or possibly more railroad mergers. The Kansas Agencies believe that now is the time to protect these shippers interests, before a final round of mergers begins which may leave us with two remaining continental Class I railroads. The Kansas Agencies have reviewed the comments filed in advance of the public hearing in STB Ex Parte 582, and found many of the merger standards recommended in those comments could alleviate a portion of our concerns. In particular, the Kansas Agencies focused on the filed comments of the National Grain and Feed Association (“NGFA”), and Western Resources, Inc. (“WRI”). The Kansas Agencies recommend the following merger standards, based upon the comments cited above:

1. Rail customers should not pay for merger premiums paid by acquiring railroads or other entities, nor should such premiums be included in the Board’s calculations of revenue adequacy. Excessive consolidation-related investments should be the responsibility of railroad management, not their customers.

2. The Board should require more pre-merger financial scrutiny regarding the impact of a proposed merger or combination on the financial health of the resulting entities. Greater

emphasis should be placed on determining whether the applicants' claims, if any, of traffic growth are realistic.

3. Efforts by railroads to gain further efficiencies or add capacity that promotes growth for U.S. agriculture should be supported. The impacts on short line and regional railroads of such efforts by Class I railroads should be carefully analyzed because significant quantities of grain and food products originate or terminate, or both, on short line and regional railroads.

4. The Board may want to consider whether it should modify its current policy of preservation of pre-merger competition and service levels to a policy of enhancing competition and service available to captive shippers. For example, means of achieving this end with regard to captive customers were recommended by WRI in its February 29, 2000 Comments, as follows:

[T]he STB should expand its policy of modifying contractual relationships between captive shippers and merging railroads if a captive shipper can demonstrate that service to its facility has deteriorated as a result of the merger. In such cases, the STB should include among possible remedies (1) the adjustment of the rate aspects of the arrangement in light of the deteriorated service levels, and/or (2) modifying contract volume requirements and providing rights to another railroad to provide rail service to the facility on a temporary or permanent basis.

5. Where Class I rail consolidations are approved, conditions should be imposed that at least preserve competition. These conditions should include:

- a. Guarantees designed to keep all existing rail gateways open – both physically and economically;

- b. reciprocal switching guaranteed at competitive rate levels. This can sometimes be accomplished through bilateral switching agreements between carriers; and
- c. any reductions in route or service options because of the merger must be remedied prior to approval of the merger. For example, if the merger results in the creation of a new "bottleneck," then the merged railroad must be required to quote rail users a separately challengeable rate to a competing carrier under all circumstances.

6. Concurrent with its changes to the rail merger regulations, the Board may wish to consider revisions to its "Bottleneck" rules as well as implementing "Bottleneck" conditions with its merger rules.

7. Railroads should provide market-based compensation to rail users damaged by service disruptions related to implementation of a rail merger or combination. Pre-merger promises or guarantees should be in writing and contain objective and enforceable standards. For agricultural rail users in particular, the NGFA Arbitration System could be utilized for fair, prompt and cost-efficient resolution of any merger-related disputes the parties cannot mutually resolve. A similar arbitration system could be implemented for use by coal shippers and receivers. This suggestion is not meant to replace the need for Board-imposed consolidation conditions.

B. NATIONAL POLICY CONCERNS

The approval of further rail mergers or combinations should include an analysis of whether changes in national transportation policy are necessary to ensure or enhance intermodal

competition. For example, this might include recommended reform of the nation's outdated maritime cabotage laws, commonly referred to as the Jones Act, which effectively eliminate the use of deepwater, self-propelled vessels for transportation of grain and other agricultural products between U.S. ports. This is particularly apparent where transnational consolidations occur. A Canadian rail shipper located at or near a Canadian Great Lakes port would have the option of shipping by rail or using any available ocean vessel to ship through the Great Lakes to any U.S. port. A U.S. shipper located at or near a U.S. Great Lakes port would be precluded by the Jones Act from using any foreign vessels for a shipment to another U.S. port. Since self-propelled Jones Act ocean-going vessels no longer serve U.S. Great Lake ports, the U.S. shipper is in a vastly different situation regarding competitive transportation alternatives than the Canadian shipper served by the same railroad.

Where transnational mergers or combinations are proposed, the Board should completely analyze and determine the effect of a foreign government's involvement or potential involvement in every aspect of the railroad. Approval of any merger which could result in a foreign government having jurisdiction over and control of rail operations in this country raises serious and significant issues and concerns. Serious consideration must be given to whether Congress has given, or ever intended to give, the Board the authority to delegate any part of its regulatory duties to a foreign government. Serious consideration must also be given to what impact such delegation could have on the distribution of rail equipment or service and on the Rail Transportation Policy of the United States Government articulated by Congress in the Staggers Act.

Where transnational mergers or combinations are proposed, the STB should completely analyze and determine the effect of a foreign government's jurisdiction on rail operations of the resulting entity or entities. Distribution of rail equipment or service and the influence of governing authorities on equipment or service allocation are significant issues.

C. ADDRESSING THE CONCERNS OF SHORT LINE RAILROADS

The Kansas Agencies are concerned with promoting and enhancing competition in the transportation of Kansas agricultural products and coal shipments to Kansas utilities. Much of the rural economy depends on short line railroads to transport grain to market. Further, as captive rail customers, coal-fired electric generation facilities are dependent on competitive rates and service for efficient and economical operation.

Short line railroads operate 2,453 miles, or 45%, of the total rail line in Kansas. However, Kansas short lines can "co-load" grain at multiple stations in one part of the state but not in another. Reduction or elimination of short line service can be expected to cause lower farm incomes, higher highway maintenance costs, and further erosion of the rural Kansas lifestyle. Adverse effects on short line railroads can also result in total dependence on inefficient, unreliable and expensive rail service for coal shipments to utility facilities, the costs and consequences of which may be passed to Kansas electric consumers. With continued mergers it is anticipated that Kansas short lines and their shippers will suffer from discriminatory pricing and car supply; restricted interchange and routing freedom (due to anti-competitive "paper" and "steel" barriers). The Kansas Agencies consider this prima facie evidence that the Class I's are anti-competitive in their grain and coal transportation operations. These issues should be addressed in these merger regulations. The

Kansas Agencies have reviewed and support the “Bill of Rights” submitted by the American Short Line and Regional Railroad Association, which proposes that:

1. Small Railroads Have the Right to Compensation for Service Failures

No Class I merger or acquisition transaction should be approved without iron-clad guarantees that short line and regional railroads will receive prompt compensating payment from the Class I to make up for revenue losses directly caused by service or local operating deficiencies resulting from the transaction. When a Class I cannot provide an acceptable level of service post-transaction, small railroads should be allowed to perform additional services as necessary to provide acceptable service to shippers.

2. Short Line and Regional Railroads Have a Right to Interchange and Routing Freedom

No Class I merger or consolidation transaction should be approved without a requirement that all contractual barriers that prohibit or disadvantage full interchange rights, competitive routes and/or rates must be immediately removed, and none imposed in the future. Also, small railroads should be free to interchange with all other carriers in a terminal area without pricing or operational disadvantage.

3. Short Line and Regional Railroads Have a Right to Competitive and Nondiscriminatory Pricing

No Class I merger or acquisition transaction should be approved without an express requirement that rates and pricing for small railroads will be competitive and nondiscriminatory.

4. Short Line and Regional Railroads Have a Right to Fair and Nondiscriminatory Car Supply

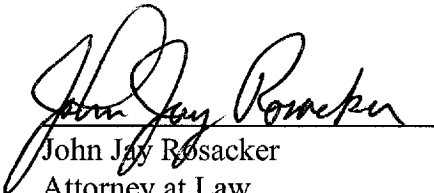
No Class I merger or consolidation transaction should be approved without a requirement that connecting small railroads will be treated in a fair and nondiscriminatory fashion with regard to car supply and car compensation.

III. CONCLUSION

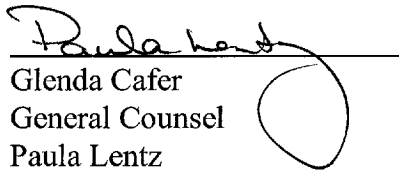
The Kansas Agencies are troubled by the recent trends in the rail industry. As the railroads continue to build into a massive transcontinental unit, matters of local concern are being left by the wayside; intrastate transport of agricultural products are being gradually dismissed and offered no competitive rail alternatives; captive coal-fired general facilities are suffering poor service and lack of competition; and short line railroads have been prevented from making up the difference. The Kansas Agencies urge the Board to take strong action in its revision of the merger rules and regulations to protect these concerns, and insure the continued compliance with the stated policy of the United States Government as outlined above.

WHEREFORE, for the reasons stated above, the Kansas Agencies request the Board give due consideration to the suggested revisions to its merger regulations.

Respectfully Submitted,



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